JAG Fixed Income Thematic Insights: Q4 2025

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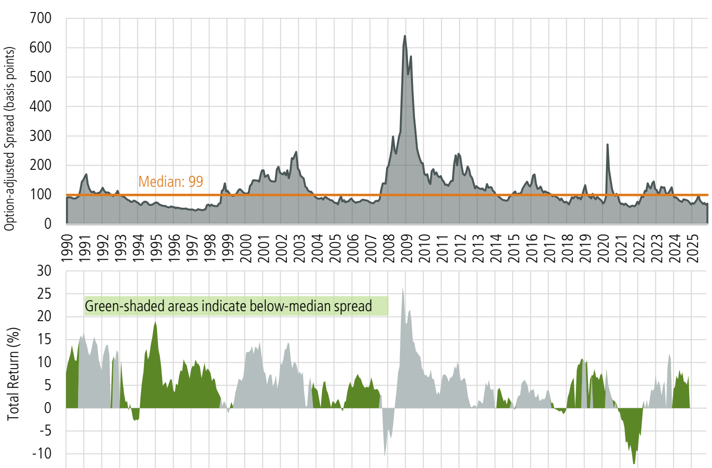
Spread Thin? Why Credit Still Deserves a Place in Portfolios

In last quarter's **Insight**, we examined the relationship between yield levels and forward return outcomes, illustrating how higher absolute yields improve the odds of favorable results over time. This quarter, we turn to a related but more nuanced factor: credit spreads. Our analysis focuses on the Bloomberg US Intermediate Corporate Index.

Spreads are a vital component of bond pricing. They reflect the additional yield investors demand for taking credit risk relative to US Treasuries. Spreads have remained persistently tight for two years. The question many ask: should we still own credit at these levels?

Spreads and Total Returns

To begin, we examine the broad relationship between spreads and **12-month forward total returns** in corporate bonds. While wide spreads have historically coincided with higher future returns – as one might expect – even low-spread environments have produced respectable outcomes more often than not.



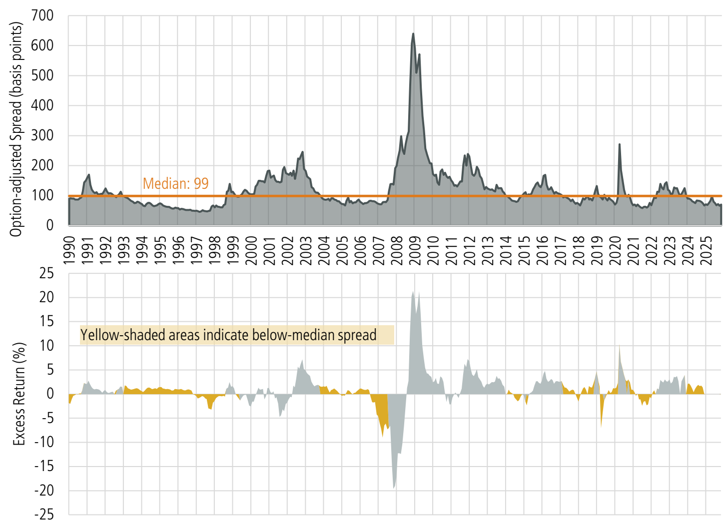
Source: Bloomberg Finance LP, JAG Capital Management

But total return includes more than just credit performance; it reflects changes in interest rates. To isolate how much of the return comes specifically from spread exposure, we turn to a more precise measure.

Excess Return Tells the Real Story

Excess return strips out the impact of duration-matched Treasuries, focusing only on how corporates perform relative to their risk-free counterparts. It is a clean way of judging how investors were compensated for taking on credit risk.

When we chart credit spreads against subsequent **12-month excess returns**, again, we find that wide spreads tend to coincide with strong results. But the real surprise is what happens when spreads are tight.



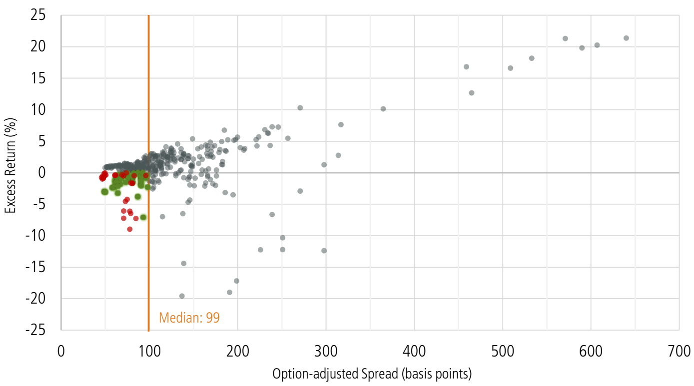
Source: Bloomberg Finance LP, JAG Capital Management

Since 1990, excess return has remained positive in over 70% of all 12-month periods. Even when spreads were below their long-term median (~99 basis points), 63% of observations were positive, with an average excess return just above 1%.

In short, while tight spreads may dampen upside, they have not historically signaled doom. Historically - more often than not - investors have still earned excess returns following periods of tighter than average spreads.

Drawdowns Often Lead to Payoffs

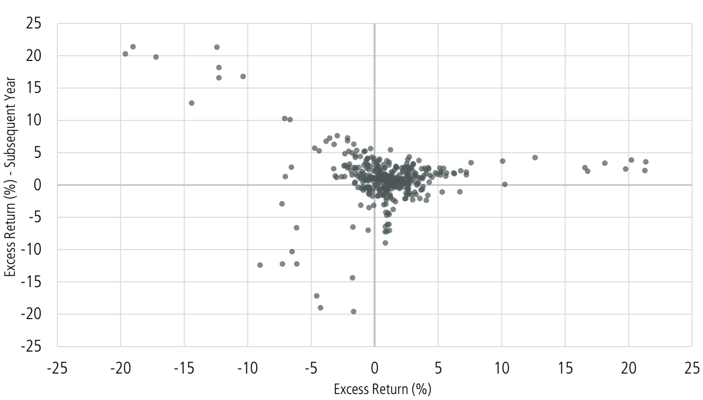
If spreads are tight and returns turn negative, the natural instinct may be to pull back. Ironically, that's often when opportunity starts to build. We color-coded the excess return scatter below to indicate what happened in the next 12-month period after a period of credit underperformance. We find that after poor outcomes, returns often recover sharply.



Source: Bloomberg Finance LP, JAG Capital Management

Some of the worst 12-month periods, often occurring when spreads were already elevated, were followed by some of the best. What felt like a breakdown turned out to be a reset.

We see a similar pattern when we ignore spread levels and simply compare excess returns with subsequent 12-month outcomes. The scatter below shows that periods of underperformance (the dots to the left of the x-axis) frequently plot positively on the y-axis.



Source: Bloomberg Finance LP, JAG Capital Management

This pattern reinforces the value of staying invested for the long term. Credit markets can and do suffer from bouts of spread-widening, but history shows those episodes frequently resolve in the investor's favor.

Final Thoughts

Tight credit spreads may dampen expected returns, but they do not represent a signal to retreat. Even when spreads fall below long-term norms, corporate bonds have historically delivered more positive excess return periods than negative ones. And while our analysis emphasizes staying invested, our team at JAG also makes portfolio adjustments intended to help navigate riskier moments as they arise.

Today's spreads might be thin, but the case for credit remains thick with history.

– JAG's Fixed Income Research Team

Disclosures

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Contribution of Expertise and Capital: Contribution of capital and/or expertise by Veteran owner(s) to acquire their ownership interest shall be real and substantial and be in proportion of the interest acquired.

Independence: The Veteran owner(s) shall have the ability to perform in their area of specialty/expertise without substantial reliance on non-Veteran-owned businesses.

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